

# **RAISING SMALL BUSINESS CAPITAL THROUGH SECURITIES**

## **STATE OF IDAHO**

Idaho Department of Finance  
Securities Bureau  
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Successful businesses require capital, particularly small businesses. Whether a company wants to expand its production capacity, introduce new products or offer new services, the number one question is how to finance it. No doubt you have already invested substantial cash and pledged assets as collateral against monies borrowed from the local bank. Your company, however, is still short of needed funds.

## **RAISING CAPITAL**

Many companies are now considering raising needed capital by issuing securities. It works like this. Usually, persons invest their money in your company in return for either (1) a promise by the company to repay them their investment plus interest OR (2) a permanent equity ownership interest in the company. The company is restricted to using investor funds only for the business purposes for which the funds were raised.

## **TYPES OF SECURITIES**

There are two basic types of securities: debt and equity.

**Debt:** A debt security is evidenced by a promise (usually in writing) to repay the person from whom the company is borrowing money the amount invested (principal) plus a rate of interest by a certain date. The rate of interest and the timing of repayment of the principal and interest due are set by the company.

**Equity:** An equity security is commonly known as stock. Stock represents a permanent ownership interest in the company. In order for a company to issue stock, it must be incorporated under state law. Articles of incorporation must be filed with the state which include the amount and type of stock the corporation wants to be authorized to issue.

Stock is evidenced by a certificate issued by the corporation which identifies the name of the investor, the number of shares purchased and the class of stock held. Generally, a stockholder will be entitled to dividends, if declared; a right to vote on certain corporate matters; and certain other rights relating to receiving corporate information, including periodic financial reports.

## **CAN ANY COMPANY ISSUE SECURITIES?**

Basically, yes. The question is really whether you are at the point in the development of your business that a securities offering makes good business sense and whether you possess the self-discipline to do it right.

## **DO YOU HAVE A PLAN?**

One of the first steps for any small business person should be the preparation of a business plan. Among other things, this plan will describe in detail your business, the market for your product or service, competition factors, location, management and current financial condition.

Accompanying documents which support your business plan will include personal resumes and financial statements, credit reports, letters of reference, job descriptions, copies of leases, contracts and other legal documents as well as other items which support the statements made in this plan.

## **BE REALISTIC**

The axiom “Crawl before you Walk” is very appropriate to small business persons raising capital through issuing securities. Concentrate on the amount of funds you need to accomplish your immediate (6-12 month) business goal. If you successfully reach that goal, you may be able to offer additional securities to finance the next objective. Beware of trying to do too much at once. A person is more likely to invest in a venture perceived as having a clear idea of the step-by-step progress of the business.

## **WHO WILL BUY?**

Generally, a small business person turns to his friends, relatives and business professionals as the most likely persons to purchase securities of the company. In addition, company suppliers, local merchants, business persons and investment clubs may be potential additional investors.

## **WHAT IF I ISSUE SECURITIES?**

If you issue a debt security (note, bond, debenture), you are obligating the corporation to pay a debt which is legally enforceable. If you issue an equity security, you are, for the price of monies received, permanently giving up part of the ownership of your corporation to other persons. By issuing securities, the corporation assumes certain legal responsibilities and obligations to investors under the state securities laws and other state statutes.

## IDAHO UNIFORM SECURITIES ACT (2004)

The Uniform Securities Act (2004) of the State of Idaho (Act) is designed to provide investors with information needed to make an informed investment decision as well as to protect investors from being victimized by dishonest promoters of fraudulent business schemes who take money from honest investors under the guise of a legitimate business enterprise but usually convert the money to their own use.

Through the Act and rules of the Department of Finance, certain obligations are imposed upon companies that want to issue securities in Idaho. By complying with these requirements, the state seeks to maintain the integrity of the investment climate in the state which, in the long run, benefits those companies attempting to raise capital from local investors.

Some important legal obligations under the Act for corporations issuing securities are:

### Disclosure

A company offering to sell securities is obligated to tell each person to whom the securities are offered all material information about the company. This is the same type of information that you would want to know before making an investment in a similar type of enterprise.

Such information would include the background of persons operating the company (including compensation paid, percentage ownership in the corporation and any transactions between the individuals and the corporation), what will be done with the monies received, a description of the terms of the offering and the type of security being offered, financial information on the assets, liabilities and cash flow of the corporation, the risks associated with investing in the corporation and **all other information which is material and required for a reasonable person to be able to make an informed investment decision.** To protect the corporation from future legal disputes, it is advisable to provide this information in writing. This disclosure document is generally known as a prospectus.

### Filing Requirements and Numerical Limitations

Securities offerings must either be (1) registered with the Department or (2) exempt from registration. Most offerings made by small businesses will be exempt from registration. A filing with the Department, however, may be necessary to obtain an exemption. For some exemptions, no filing is required.

Where an exemption filing is required, the corporation usually must file a form and an offering document with the Department of Finance before beginning a securities offering and may have to adhere to certain limitations on the number of persons to whom offers and sales of securities may be made as well as certain other specific conditions.

The consequences for not making a filing when required or exceeding these numerical limitations can be costly as well as embarrassing. A phone call or letter to the Department's Securities Bureau at (208) 332-8004 **BEFORE YOU ACT** is a low-cost way to obtain accurate information about your specific circumstance.

## Civil Liability

The Act imposes civil liability on corporations and their officers and salesmen issuing securities in violation of the Act. Generally, this means that an investor who purchased a security from the company while the company was in violation of the Act will be able to sue the company for the full price paid plus interest at 6% from the date of purchase. As the company probably already has spent the funds received from investors, it has precious little capital left to repay investors for securities law violations, let alone the expense of defending a lawsuit. In addition, the Department may file suit in cases of violations. Criminal penalties exist for instances of willful fraud and intentional violations.

## U.S. Securities and Exchange Commission and Other State Regulators

The U.S. Securities and Exchange Commission (SEC) is a federal agency which administers the Securities Act of 1933 and the Securities Exchange Act of 1934. These federal laws regulate national securities exchanges and deal broadly with interstate securities transactions. Generally, compliance with SEC regulations is necessary when an offering of securities is made across state lines, including use of the mails or other methods of communication.

As each state has a securities law, a person offering securities in more than one state should consult with that state's securities commission on applicable rules for the conduct of a securities offering in that jurisdiction. It must be underscored that, in a multi-state securities offering, compliance with the rules of the Idaho Securities Bureau DOES NOT constitute automatic compliance with any applicable SEC rules or requirements of any other state securities commission.

With respect to SEC requirements, the SEC maintains an Office of Small Business Policy within the Division of Corporation Finance at 450 Fifth St., N.W., Washington, D.C. 20549 **(202) 942-2950**. The addresses and the telephone numbers of other state securities commissions may be obtained from the North American Securities Administrators Association, 10 G St., N.E., Suite 710, Washington, D.C. 20002 **(202) 737-0900** or from this office.

## A WORD OF CAUTION

Undertaking a securities offering is a **serious** matter. It will cost some money and will take time away from running your business. When offering an equity security, you are selling to other persons a permanent part ownership in your corporation. Although you may retain control, the investors will have legal rights and you will have obligations to them, including providing annual financial information.

Ask yourself some basic questions. Do you have a clear sense of where your business is going and why you need the funds? Have you prepared a business plan? Are you willing to provide written documentation to investors describing your company, the offering, and the risks associated with investing in your enterprise? Are you willing to comply with all applicable requirements of the Act?

## WHERE CAN I GET HELP?

Several sources are available. First, you may wish to consult your attorney or accountant. If you are not yet incorporated, most likely an attorney would be needed to accomplish that task.

Second you are invited to call the Idaho Securities Bureau. The Securities Bureau has examiners willing to inform and educate small business persons about raising capital by issuing securities.

A call to the Department's Securities Bureau at (208) 332-8004 will put you in touch with a small business specialist who will attempt to answer your questions.

Finally, you can contact one or more of the following organizations that are available to provide assistance and information to small businesses:

Idaho Small Business Development Center  
State Office  
Boise State University  
1910 University Drive  
Boise, ID 83725  
**1-800-225-3815 – in-state**  
**(208) 426-3875**

The ISBDC is a network of six business assistance officers throughout Idaho. Publications, training and one-on-one counseling are available, including information on how to prepare a business plan.



SCORE, the Service Corps of Retired Executives (Treasure Valley office)  
380 East Parkcenter Blvd. Suite 330  
Boise, ID 83706  
**(208) 334-1696**

SCORE (Eastern Idaho office)  
2300 North Yellowstone, Suite 119  
Idaho Falls, ID 83401  
**(208) 523-1022**

SCORE is a national volunteer organization of experienced individuals who offer one-on-one counseling to small business owners.



U.S. Small Business Administration  
380 East Parkcenter Blvd. Suite 330  
Boise, ID 83706  
**(208) 334-1696**

The SBA has publications, administers a number of programs and provides advocacy for small businesses.

## **IT'S NOT ALL HERE!**

This brochure is meant only to acquaint the small business person with the possibility of raising capital through a securities offering. It **SHOULD NOT** be relied upon to **ACTUALLY** make a securities offering. There are many important, but technical items, with which a person making a securities offering must comply. This brochure summarizes only some of these issues. If you want to know more, call the Securities Bureau.